

**DISTRICT OF COLUMBIA HEALTH & HOSPITALS
PUBLIC BENEFIT CORPORATION**

Notes to Financial Statements

September 30, 2000

(h) *Impairment of Long-Lived Assets*

During 1996, the PBC adopted the Statement of Financial Accounting Standards (SFAS) No. 121 *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*. Under the provisions of this Statement, the PBC evaluates its long-lived assets for financial impairment, and will continue to evaluate them as events or changes in circumstances indicate that the carrying amounts of such assets may not be fully recoverable.

The Company evaluates the recoverability of long-lived assets not held for sale by measuring the carrying amount of the assets against the future undiscounted cash flows associated with them. At the time such evaluations indicate that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their fair values. See footnote 11 for description of current year impairment.

(i) *Income Taxes*

The PBC is a not-for-profit corporation and qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been recorded.

(j) *Prior Period Adjustments*

At September 30, 1999 the PBC had included in its current assets approximately \$10,233,000 of amounts due from the District of Columbia Medicaid intermediary. The intermediary had indicated to Management of the PBC that these amounts were not due to the PBC under existing Medicaid statutes. Management at the time decided not to write off these uncollectible accounts receivable. As a result, the predecessor auditors of the PBC *qualified their opinion on the financial statements as of and for the year ended September 30, 1999.*

New management of the PBC concurred with the Medicaid intermediary's ruling and wrote off these receivables in 2000. Accordingly, the fund balance of the PBC at September 30, 1999 has been restated to reflect a reduction of \$10,233,000 for the correction of this error; consequently, the excess of revenues over expenses as previously reported for the year ended September 30, 1999 was overstated by the same amount.

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(3) Net Patient Service Revenue

The PBC has agreements with third-party payors that provide for payments to the PBC at amounts different from established rates. A summary of the payment arrangements with major third-party payors follows:

(a) Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute, certain outpatient services, and capital and medical education costs related to Medicare beneficiaries are paid based upon a cost reimbursement methodology. Effective August 1, 2000, the Medicare program changed its payment methodology for outpatient services to a prospective payment system, the ambulatory payment classification system whereby providers will be reimbursed for service based on a predetermined rate per procedure. The PBC is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the PBC and audits thereof by the Medicare fiscal intermediary.

(b) Medicaid

Inpatient and outpatient services rendered to District of Columbia Medicaid program beneficiaries are reimbursed on a reasonable-cost basis. The PBC is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the PBC and audits thereof by the Medicaid fiscal intermediary.

(c) Blue Cross

Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed based upon prospectively determined rates per case. Such rates vary according to a patient classification system that is based on clinical and diagnostic factors.

(d) District Agencies

Inpatient and outpatient services rendered to patients who are under the jurisdiction of the Youth Services Administration, or the Police Department are not specifically reimbursed by those agencies. The District's annual appropriation, together with its coverage of PBC expenses in excess of collections, becomes the reimbursement methodology for these patient care services.

The PBC has also entered into payment agreements with certain commercial insurance carriers. The basis for reimbursement under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

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(4) Estimated Third-Party Settlements

Services (inpatient and outpatient) rendered by the PBC are reimbursed by several third-party payors at cost, based upon cost reports filed subsequent to year end. Contractual allowances are recorded based upon preliminary estimates of reimbursable costs. The PBC's net patient revenue recorded under cost reimbursement agreements for the current and prior years are subject to audit and retroactive adjustment by third-party payors for the following years.

Medicare	FY 1998 through FY 2000
Medicaid	FY 1997 through FY 2000

Final Notices of Program Reimbursements (FNPR) relating to Medicaid cost reports for fiscal years 1994 through 1996 and relating to Medicare for fiscal years 1995 through 1997 were received by the PBC. Settlements with all third-party payors for cost reporting periods prior to the current year have been accounted for as changes in estimates and have had the effect of increasing net patient services revenue by approximately \$7,078,000 for the year ended September 30, 2000.

The Clinics were licensed in 2000, retroactive to June 30, 1999. In November 2000, the PBC began billing under these licenses. Management is in the process of requesting that Medicaid reprocess all claims from the effective date to the date of licensure. No amounts have been recorded in these financial statements related to this issue.

(5) Buildings and Equipment

A summary of buildings and equipment at September 30 follows:

<i>Buildings and improvements</i>	\$ 83,472
Fixed equipment	21,141
Major moveable equipment	<u>36,211</u>
	140,824
Accumulated depreciation	(106,391)
Reserve for impairment of long-lived assets	<u>(32,433)</u>
	\$ <u>2,000</u>

(6) Charity Care

The PBC maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. Charity care, measured by the level of charges foregone based on established rates, was approximately \$81,778,000 in 2000.

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(7) Related Parties

In 1997, the responsibility for overseeing the operations, the administrative and functional authority, and the uses of the Clinics was transferred to the PBC. The PBC received a transfer of approximately \$13,344,000 from DHS through the Intra-District process related to the operations of clinics for the year ended September 30, 2000. The PBC also entered into an agreement with DHS to provide Maternal and Child Health Services to the residents of the District. Included in the transfer from DHS, the PBC received \$1,000,000 through the Intra-District process to provide these services.

The District provides the PBC with certain central accounting and other administrative services, such as treasury and cash management functions, and pays disability and unemployment benefits on behalf of the PBC's employees. The District also pays for interest on District financing of the PBC's fixed-asset acquisitions, manages the PBC's cash which is pooled with the funds of other agencies, and provides funding for any medical malpractice liability settlements against the PBC. The PBC does not reimburse the District for these expenses which amounted to approximately \$12,557,000 for the year ended September 30, 2000. The District also provides capital contributions for the purchase of buildings and equipment. No contributions for capital improvements were made in 2000.

The PBC provides generated steam and use of office space for certain District agencies. Revenues received and related costs are recorded as Intra-District revenue and other expenses, respectively, in these financial statements. Other services, such as medical care to District wards (including inmates of the District prison system) and use of PBC office facilities, are provided to District agencies at no cost to them and are therefore not reflected in these financial statements.

The PBC received funds for certain programs from the D.C. General Hospital Foundation, Inc. (the Foundation), a tax exempt corporation under Section 501(c)(3) of the Internal Revenue Code. The Foundation was organized and is operated for the exclusive benefit of the PBC by assisting in the development of educational and community service programs, studies, and other similar activities. Revenues received and related costs are recorded as Intra-District revenue and other expenses. Funds due to the PBC are reflected in accounts receivable of the Foundation at September 30, 2000 was approximately \$1,129,000. Total contributions to the PBC approximated \$1,940,000 for the year then ended.

(8) Commitments and Contingencies

(a) Operating Leases

During 2000, the PBC was party to various one-year operating equipment leases. Total rental expense for the year ended September 30, 2000, was approximately \$875,000.

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(b) *Litigation*

The PBC is involved in litigation and regulatory investigations arising in the course of business. The PBC is self-insured for non-tort claims and, after consultation with outside legal counsel, has accrued approximately \$6.4 million at September 30, 2000 related to these claims. In addition, the PBC is also a defendant to an additional amount of approximately \$8.7 million which outside counsel has deemed a possible contingency. As noted in footnote 7, the District is responsible for all tort related claims, including medical malpractice, asserted against the PBC.

In 2000, the District provided funds that approximated \$1,884,000 for medical malpractice settlements against the PBC. The PBC is not required to reimburse the District for these expenses.

(9) Retirement Plan

PBC employees hired prior to September 30, 1987 are covered by a defined contribution pension plan under the Civil Service Retirement System (5 U.S.C. 8331), and these employees contribute 7.25% of their salaries to this plan. The PBC contributes an additional 8.51%, which amounted to approximately \$3,221,000 in 2000.

Such amounts are reported in salaries and benefits expense. These amounts are paid to the U.S. Civil Service Commission, which is responsible for administering this system and disbursing the benefits thereunder. The District sponsors the District of Columbia Defined Contribution Pension Plan (DC Code 1-627) as a qualified trust under Internal Revenue Code Section 401(a) for permanent full-time employees covered by the Social Security System. The District contributes 5% of base salaries each for eligible employees each pay period. Employees do not contribute to the plan and are eligible to participate after one year of service. Contributions and earnings vest fully after four years of service following a one year waiting period. Contributions and earnings are forfeited if separation occurs before five years of credited service. The District contributed approximately \$1,733,000 for PBC employees during the year ended September 30, 2000. The PBC participates in the District-sponsored deferred compensation plan (D.C. Code 47-3601) which is administered by independent contractors under Internal Revenue Code Section 457 and is accounted for as a separate Deferred Compensation Expendable Trust Fund. Employees may defer up to 25% of their annual compensation, not to exceed \$8,000. Compensation deferred and income earned are taxable when paid or made available to the participant or beneficiary upon retirement, death, termination, or unforeseeable emergency.

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(10) Concentration of Business and Credit Risk

Patient accounts receivable and patient service revenue consists of amounts earned for patient care provided at the PBC. Payments for patient care are generally made on behalf of patients by third-party payors, including the federal government, the District, Blue Cross and other private insurance carriers, HMOs, PPOs, and other managed care programs. Payments are also made directly by patients. Patient and managed care services are generally provided without requiring collateral from patients, third-party payors or others.

A breakdown of the percentage of gross patient service revenue by type of payor is as follows:

Medicaid	26%
Medicare	18%
Self-Pay	32%
Commercial	7%
Other (none more than 10%)	17%

A breakdown of the percentage of gross patient accounts receivable by type of payor is as follows:

Medicaid	34%
Medicare	17%
Self-Pay	22%
Other (none more than 10%)	27%

(11) Impairment of Long-Lived Assets

In September 2000, the PBC recorded a non-cash impairment loss of \$32,433,000 related to a write-down of buildings and equipment. The write-down resulted from the PBC's inability to generate positive cash flow from operations and the expectations that this situation will continue into the foreseeable future.

As a result, the projected future cash flows from this facility are less than the carrying value of the assets; therefore, an impairment loss has been recognized. The impaired assets include buildings and machinery and equipment used to provide patient care. These assets were written down to their estimated fair value based on the salvage value of the assets. The recognition of this impairment was in accordance with the provisions of Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long-Lived Assets and For Long-Lived Assets to be Disposed Of*.

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(12) Liquidity and Going Concern

The PBC has suffered recurring losses from operations, has a working capital deficit at September 30, 2000 and has relied on financial support from the District. The PBC received appropriations from the District and Department of Human Services totaling approximately \$97,184,000 for the year ended September 30, 2000 and was indebted to the District for \$42,059,000 as of September 30, 2000 for disbursements made by the District on the PBC's behalf in excess of appropriations, cash collections and capital contributions.

Under the PBC Act, the District is required to enter into an annual agreement to compensate the PBC for uncompensated care, for health and medical services provided to individuals who are wards of the District and other services as specified in the agreement. The District has committed to funding the PBC up to \$90,000,000 for fiscal year 2001. Reductions in or the elimination of funding from the District would have a significant effect on the PBC's operations and financial statements.

As directed under the Omnibus Spending Reduction Act of 1993, Title IV (D.C. Law 10-65), the Mayor, with the Executive Director and representatives of the Hospital collective bargaining units, developed a plan to restore financial solvency at the Hospital through structural reforms, including revisions in scope of services, major reductions in staffing levels, strict control over expenditures for non-personal services, reduction in inventory levels, and numerous revenue enhancement initiatives aimed at improved billing and collection of revenue. In addition, the PBC is pursuing affiliations with other health care providers to improve its financial future. The PBC is considering two proposals from health care providers to replace the Hospital as the provider of medical services to its currently served population. The PBC intends to award the long-term contract sometime in fiscal year 2001. If the PBC awards the contract, medical services previously provided by the PBC may, in the future, be provided by other health care entities. Both inpatient and outpatient services may or may not cease to operate.



A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses as described below.

During much of fiscal year 2000, the PBC's accounting functions were performed by a third-party service organization. The PBC maintains separate bank accounts in addition to participating in the District's pooled cash management program. It also maintains several subsidiary ledgers to account for its patient accounts receivable and various other account balances such as building and equipment. The PBC uses the District's SOAR system as its general ledger and is required to post and reconcile its separate bank accounts and receivable subledger activity to the amounts recorded in the general ledger. During a portion of fiscal year 2000, no subsidiary ledger activity was reconciled to the related general ledger control accounts. This situation prevented the PBC management from fully analyzing the collectibility of its third party receivables and to allow it to convert those receivables into cash on a timely basis. Additionally, it prevented the PBC management from closing its books for fiscal year 2000 timely.

A contractor was subsequently hired to assist the PBC in recording financial activity, reconciling bank accounts and subsidiary ledgers, posting adjustments, and preparing the PBC's financial statements for fiscal year 2000. As the PBC works through the aspects of a proposed restructuring during fiscal year 2001, we recommend that particular attention be given to ensuring the financial activity of the PBC is accurately and timely recorded in order to facilitate the important financial decisions which will need to be made regarding the PBC's ongoing financial operations.

This report is intended for the information of the Inspector General of the Government of the District of Columbia, Board of Directors of the District of Columbia Health and Hospitals Public Benefit Corporation, and management and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 19, 2001



2001 M Street, N.W.
Washington, D.C. 20036

**Report on Compliance and on Internal Control Over Financial
Reporting Based on an Audit of Financial Statements Performed
in Accordance with Government Auditing Standards**

The Inspector General of the Government of the District of Columbia
The Board of Directors of the District of Columbia Health and Hospitals Public Benefit Corporation
Washington, D.C.:

We have audited the financial statements of the District of Columbia Health and Hospitals Public Benefit Corporation (the PBC) as of and for the year ended September 30, 2000, and have issued our report thereon dated January 19, 2001, which included an explanatory paragraph as to the PBC's ability to continue as a going concern. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the PBC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Governmental Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the PBC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the PBC's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

